

Part III

Administrative, Procedural, and Miscellaneous

Section 807. – Rules for Certain Reserves (Also §§ 805, 812, 832)

Rev. Proc. 2007-61

SECTION 1. PURPOSE

This revenue procedure provides a safe harbor under which an insurance company subject to tax under subchapter L of the Internal Revenue Code is not required to take into account any portion of the increase for the taxable year in policy cash values of life insurance contracts described in § 264(f)(4)(A) (I-COLI Contracts) for purposes of applying the insurance company proration rules in §§ 807(a)(2), 807(b)(1), 805(a)(4), 812, or 832(b)(5).

SECTION 2. BACKGROUND

.01 Insurance company proration rules. (1) To clearly reflect income, an insurance company is allowed to deduct increases in certain insurance reserves reflecting the company's obligations to policyholders. Like other taxpayers, an insurance company may receive tax-favored income, such as tax-exempt interest,

intercorporate dividends, and the inside build-up under life insurance contracts.

Because a portion of the reserve increase can be viewed as funded by tax-favored income, the insurance company proration rules require that tax-favored income be prorated between the insurance company and its policyholders. See §§ 807(a) and (b) (requiring that a life insurance company's deductible reserves be reduced by the "policyholders' share" of certain tax-favored income) and § 832(b)(5)(B) (requiring that a property and casualty insurance company's deductible additions to reserves be reduced by 15 percent of tax-favored income). See also § 805(a)(4) (generally limiting a life insurance company's deduction for dividends received to the "company's share" of the dividends); § 812 (setting forth the methodology for determining the company's share and the policyholder's share).

(2) Prior to 1997, the tax-favored investment income items taken into account under the insurance company proration rules were tax-exempt interest and intercorporate dividends. In the Taxpayer Relief Act of 1997, 1997-4 C.B. (Vol. 1) 165-69 ("1997 Act"), Congress amended §§ 807(a)(2), 807(b)(1), 805(a)(4), 812(d)(1), and 832(b)(5) to take into account "the increase for the taxable year in policy cash values . . . of life insurance policies and annuity and endowment *contracts to which section 264(f) applies.*" (Emphasis added.) See § 1084(b) of the 1997 Act. The legislative history explained:

[T]he rules reducing certain deductions for losses incurred, in the case of property and casualty companies, and reducing reserve deductions or dividends received deductions of life insurance companies, are modified to

take into account the increase in the cash values of life insurance policies or annuity or endowment contracts held by insurance companies.

H. R. Rep. No. 105-220, 105th Cong., 1st Sess. 588 (1997), 1997-4 (Vol. 2) C.B. 2058.

.02 Contracts to which § 264(f) applies. The IRS and the Treasury Department have become aware of questions concerning the interpretation of the phrase “contracts to which § 264(f) applies.” For example, it may be argued that § 264(f) does not “apply” to contracts described in § 264(f)(4)(A) (*i.e.*, contracts covering 20-percent owners, officers, directors and employees) because those contracts are excepted from the disallowance rule of § 264(f)(1). Alternatively, it may be argued that the § 264(f)(4)(A) exception applies only for purposes of the disallowance rule of § 264(f)(1) and that other provisions of § 264(f) continue to “apply” to contracts covering 20-percent owners, officers, directors and employees. See, *e.g.*, § 264(f)(4)(C).

SECTION 3. SCOPE

This revenue procedure applies to I-COLI Contracts covering no more than 35 percent of the total aggregate number of the individuals described in § 264(f)(4)(A) at any time during the taxable year.

SECTION 4. SAFE HARBOR

For purposes of applying the insurance company proration rules in §§ 807(a)(2), 807(b)(1), 805(a)(4), 812, or 832(b)(5), an insurance company is not required to take into account any portion of the increase for the taxable year in the policy cash values (within the meaning of section 805(a)(4)) of I-COLI contracts to which this revenue

procedure applies pending the publication of additional guidance. Arrangements involving such contracts, however, remain subject to challenge by the IRS under other provisions of the tax law, including judicial doctrines such as the business purpose doctrine.

SECTION 5. EFFECTIVE DATE

This revenue procedure is effective September 11, 2007. If, in response to comments, additional guidance is published interpreting the phrase “contracts to which section 264(f) applies,” such guidance will apply prospectively.

SECTION 6. REQUEST FOR COMMENTS

.01 Comments are requested concerning the need for additional guidance in this area. Specifically, comments are requested regarding the existence of any non-tax regulatory rules or other requirements that limit an insurance company’s ability to invest in I-COLI Contracts and the effect of any experience rating, inter-insurance, reciprocal, or reinsurance arrangement on transactions involving I-COLI Contracts. In addition, the IRS would welcome comments on the operation of arrangements involving I-COLI Contracts.

.02 Comments should be submitted by December 31, 2007. Comments may be submitted by mail addressed to: Internal Revenue Service, P.O. Box 7604, Ben Franklin Station, Washington, D.C. 20044, Attn. CC:PA:LPD:PR (Rev. Proc. 2007-61), Room 5205; by hand delivery (Monday through Friday between the hours of 8:00 a.m. through 4:00 p.m.) addressed to: Courier’s Desk, Internal Revenue Service, Attn.: CC:PA:LPD:PR (Rev. Proc. 2007-61), Room 5205, 1111 Constitution Avenue, NW,

Washington, DC 20224; or by email addressed to:

Notice.Comments@irscounsel.treas.gov. Commentators should include the identification number of the publication (Rev. Proc. 2007-61) in both the email subject line and the body of the comment. All materials submitted will be available for public inspection and copying.

DRAFTING INFORMATION

The principal authors of this revenue procedure are Stephen D. Hooe and John E. Glover of the Office of Associate Chief Counsel (Financial Institutions & Products). For further information regarding this notice contact Messrs. Hooe or Glover (202) 622-3900 (not a toll-free call).